

Markets Monthly

Month of two halves

- Global markets started 2010 in an optimistic mood, but positive sentiment short-lived.
- Fears of a Greek sovereign default and growth concerns in China drive safe-haven flows.
- Global bond yields, equity indices and peripheral currencies end January lower.

January proved to be a mixed month for markets. While risk aversion appeared to have diminished going into 2010, the positive sentiment was short-lived. Fears of a Greek sovereign default and measures by the People's Bank of China to tighten monetary conditions reignited concerns about the global growth outlook. This saw equities and interest rates globally reverse the increases that had occurred earlier in the month. Similarly, demand for peripheral currencies waned, and the New Zealand and Australian dollar depreciated in the second half of the month.

Concerns over the ability of Greece to repay its sovereign debt were highlighted when the incoming government released its estimate for the 2009 budget deficit at 12.7% of GDP, double the outgoing government's estimate. In addition, there are fears that Greece's funding pressures could spill over to the other fiscally weak members of the euro zone such as Portugal, Italy, Spain and Ireland.

Meanwhile, the People's Bank of China moved to raise reserve requirements for private banks in response to signs that its economy may be overheating. Markets took this move as negative for global growth given demand from China is seen as key to the global economic recovery.

Disappointing data on US economic activity also heightened concerns about the growth outlook. In particular, weaker than expected employment, retail sales and house sales data reminded the markets that some areas of the US economy remain weak and the recovery was likely to be gradual. Nonetheless, the FOMC's 27 January meeting provided a more upbeat commentary on the US economy in acknowledging that activity has continued to strengthen and the board's expectations of a moderate economic recovery over 2010.

Overall, equity indices, bond yields and the NZ dollar ended January lower as the re-emergence of risk aversion over the second half of the month saw demand for risky assets such as equities and high-yielding currencies fall in favour of the relative safety of government bonds.

Date	Instrument	31-Jan-10	Month %	Quarter %	Year %	5-Year %
Cash	NZ cash rate	2.50	0.00	0.00	-1.00	-4.00
	NZ 90-day bank bill	2.76	-0.04	-0.03	-0.90	-4.01
	US 90-day bank bill	0.25	0.00	-0.03	-0.92	-2.49
	NZ - US 90-day bank bill	2.51	-0.04	0.00	0.02	-1.52
Fixed	NZ 5-year gov't stock	5.21	-0.32	0.04	1.48	-0.90
Interest	NZ 10-year gov't	5.96	-0.16	0.19	1.61	-0.09
	NZ 10-year swap	5.92	-0.24	-0.29	1.40	-0.88
	AUS 10-year gov't	5.45	-0.28	-0.12	1.36	0.04
	US 10-year gov't	3.62	-0.17	0.21	0.79	-0.54
Equities	NZ - NZX50 (NZ\$)	2096	-2.1%	-2.5%	7.8%	-31.8%
	AUS - All Ords (A\$)	4597	-5.9%	-1.1%	32.2%	11.9%
	JAP - Nikkei (¥)	10198	-3.3%	1.6%	27.6%	-10.4%
	UK - FT100 (£)	5189	-4.1%	2.9%	25.0%	6.9%
	US - S&P500 (US\$)	1074	-3.7%	3.6%	30.0%	-9.1%
	WORLD - MSCI (US\$)	1120	-4.2%	1.2%	33.5%	-2.0%
	MSCI in NZD (NZ\$)	1590	-1.7%	3.0%	-3.6%	-1.1%
Exchange	NZD/USD	0.704	-2.5%	-1.7%	38.5%	-0.9%
Rates	NZD/AUD	0.789	-2.3%	-1.2%	-0.1%	-14.1%
	NZD/JPY	63.3	-5.2%	-2.2%	39.4%	-14.0%
	NZD/GBP	0.436	-2.9%	-0.3%	21.9%	15.8%
	NZD/EUR	0.505	0.3%	3.7%	28.1%	-7.4%
	NZ TWI	64.7	-2.1%	-0.1%	25.8%	-6.4%
	EUR/USD	1.39	-2.8%	-5.3%	8.1%	7.0%

Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.

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General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

Cash

- The RBNZ kept the OCR unchanged at 2.5% at the January 28 meeting. In addition, it noted that economic developments since the December *Monetary Policy Statement* were in line with its expectations and reiterated it expected “to begin removing policy stimulus around the middle of 2010”.
- The speech from RBNZ Governor Alan Bollard subsequently suggested that use of alternative policy instruments may limit the amount of OCR increases required in the upcoming tightening cycle. Overall, whilst significant the two events garnered little market reaction, and markets continue to price in a rate increase by June this year.
- Term deposit rates remain high, with the returns for long-term deposits significantly higher than for the OCR. 5-year bank term deposits are yielding around 6.75%.

Fixed interest

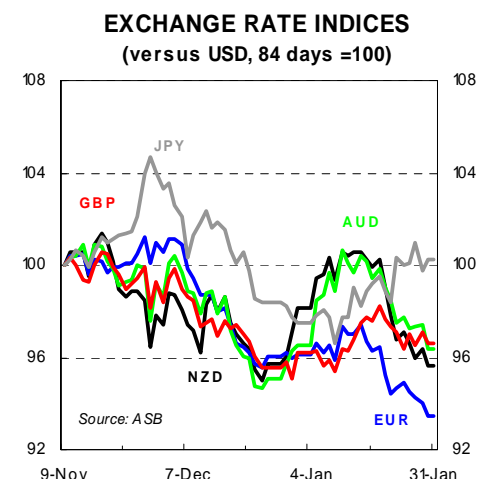
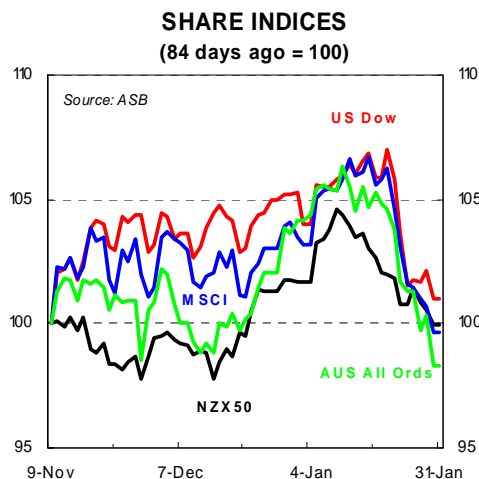
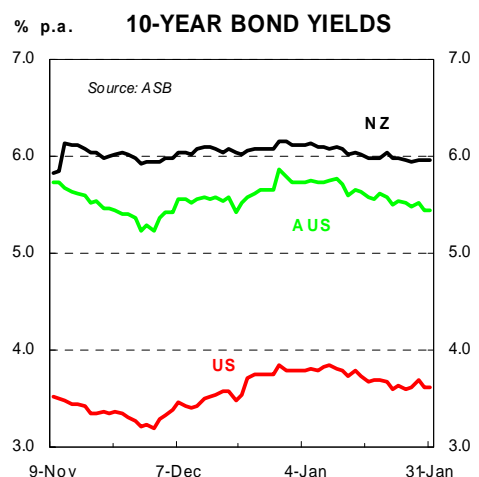
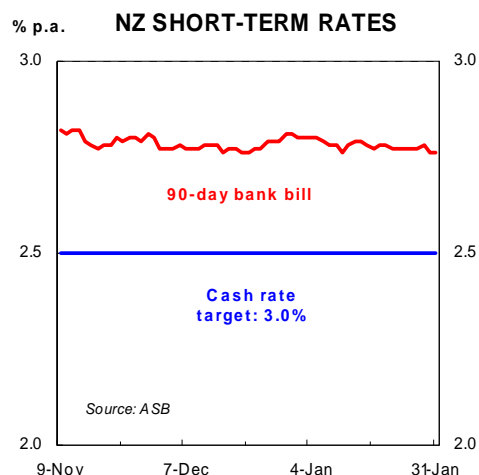
- US and Australian 10-year government bond yields fell over the month (down 17 and 28 basis points respectively). Meanwhile, NZ government bond yields fell 16 basis points.
- Heightened risk aversion drove bond yields lower globally. Key to the increased caution in markets were growing concerns about Greece’s precarious fiscal position. As a result, demand for safe haven assets such as higher-rated government bonds increased, thus pushing yields lower.
- In NZ the larger fall in shorter-term interest rates (relative to long-term interest rates) meant a steepening of the yield curve. While much of this reflected the movement in offshore interest rates, subdued non-tradable inflation also weighed on shorter-term interest rates as it was seen as reducing the urgency for the RBNZ to raise the OCR.

Equities

- NZ equity markets were lower over the month in line with movements in the Australian equity markets, with respective market benchmarks down 2.1% and 5.9% respectively.
- While share markets globally started the year strongly, concerns about global growth mounted during the month. The state of Greece’s finances was a concern in Europe. In Asia, the People’s Bank of China has expressed concern about the potential for China’s economy to overheat and began to tighten monetary conditions.
- In the US, the announcement from US president Obama plans to impose greater regulation on banks weighed on equity markets. Overall, weaker economic data overshadowed positive earnings reports from major companies, with the US equity market benchmark indices ending the month lower.

Exchange rates

- The NZ Trade-Weighted index ended the month of January lower reflecting heightened risk aversion, lower OCR expectations and a stronger USD. While the NZD started the year strong, gains were reversed over the second half of the month on heightened risk aversion.
- The USD ended January higher as risk aversion provided a boost for the USD over the second half of the month. TICS data released in January confirmed that private sector investment flows into the US have increased.
- The Euro was dragged lower by concerns over Greece’s debt levels and data indicating continued weakness in euro zone economic activity. In particular, October industrial new orders, November retail sales and unemployment disappointed markets.



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